

IRS News Release

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Treasury Issues Rules to Increase Transparency and Halt Abusive Tax Avoidance Transactions; Reins Tightened on Lawyers, Accountants, and Other Tax Advisers

IR-2003-147, Dec. 29, 2003

WASHINGTON — Today the Treasury Department and the IRS issued four items of administrative guidance as part of their ongoing effort to halt abusive tax avoidance transactions and maximize effective use of IRS audit resources. The first of the items released today is aimed at strengthening the tax system through heightened standards for tax advisors. The other three are aimed at increasing transparency and disclosure of information to the IRS. Improved disclosure coupled with more effective use of the information disclosed are central to the Treasury Department and IRS's strategy for identifying abusive tax avoidance transactions early and addressing them promptly. In addition, the transparency that disclosure brings serves as a deterrent to abusive tax avoidance transactions.

"Taken together, the actions we are announcing today represent another significant step to end the proliferation of abusive tax avoidance transactions that has undermined confidence in our tax system," said Treasury Assistant Secretary for Tax Policy Pam Olson. "We are proposing a set of best practices that makes clear that tax professionals should adhere to the highest ethical standards and ensure that their clients are well-advised of the law and any risks they are taking."

- **Proposed changes to Circular 230 that set high standards for the tax advisors and firms that provide opinions supporting tax-motivated transactions.**
 - The proposed rules set out clear and specific requirements for tax opinions provided by attorneys and accountants and expectations for those with supervisory responsibility for a professional services firm's tax practice.
 - In an effort to halt the rush to the bottom that pervaded the 1990s and restore the confidence of the public in tax professionals, the proposed changes also describe best practices for tax advisors and call on professional services firms to put in place procedures for all of the firm's personnel that are consistent with these best practices.
 - To ensure clients are well-advised, the proposed changes would obligate tax advisors to inform clients explicitly about what protections, if any, an opinion provides to the client. For example, tax advisors would have to advise

clients about issues that the opinion does not address and warn the client if the opinion will not protect the client against penalties.

- The Treasury Department and the IRS are working with professional organizations to promote best practices among tax professionals through setting aspirational standards and self-regulation. The proposed changes would put in place a framework for that effort.
- The proposed changes replace changes proposed in January 2001. They reflect a careful consideration of the comments received on the January 2001 proposals and information gathered by the IRS in its audit of professional services firms' compliance with the tax shelter rules.
- **Final regulations that will increase the cost of failing to disclose abusive tax avoidance transactions.** The regulations also apply to taxpayers who do not disclose that they have reported items on their tax returns that are based on the position that a Treasury regulation is invalid. Under the final regulations, for purposes of the imposition of penalties, a taxpayer's failure to disclose an abusive tax avoidance transaction is treated as a strong indication that the taxpayer acted in bad faith with respect to any additional tax owed as a consequence of the transaction. Similarly, taxpayers who do not disclose items that are based on advice that a Treasury regulation is invalid will be deemed to have acted in bad faith with respect to any additional tax that is owed as a consequence of those items.

"We are taking the administrative steps we can under current law to create downsides for those who choose not to disclose by making it clear that failing to disclose significantly increases the likelihood of penalties being imposed," continued Assistant Secretary Olson. "Having the IRS hunt for an abusive transaction hidden on a tax return is a waste of IRS resources. If a taxpayer is willing to enter into a transaction, then the taxpayer should be willing to disclose that transaction on its return."

- **Revised final regulations clarifying that the disclosure of confidential transactions on a return is limited to transactions for which a promoter has imposed confidentiality on a taxpayer to protect the promoter's tax strategies from disclosure.** The revisions are intended to reduce unnecessary paperwork for taxpayers and advisors and to allow the IRS to focus its attention on transactions with potential for abusive tax avoidance, not on transactions for which confidentiality is required for non-tax reasons.

"We continue to believe that sunshine is the best disinfectant for abusive transactions," noted Assistant Secretary Olson. "Ensuring that the rules are focused appropriately on the transactions with potential for abusive tax avoidance will further that goal. Burdening taxpayers and burying the IRS with useless paper will not. As a consequence, we have narrowed the disclosure of confidential transactions to situations in which the promoter imposed confidentiality to keep the promoter's tax strategy out of view."

- **Proposed new Form 8858 requiring information reporting by U.S. persons that own foreign entities that are disregarded for U.S. tax purposes.** The need for information is not limited to the area of abusive tax avoidance

transactions. Appropriately tailored disclosure and information reporting requirements provide the means to better focus the audit resources aimed at protecting the integrity of our tax system. Ready access to information allows the IRS to identify potential compliance issues efficiently and is critical to achieving the IRS's commitment to reducing the time needed to complete an audit. The proposed Form 8858 will be required for annual accounting periods beginning after December 31, 2003. Comments on the text of the proposed new Form 8858 are requested from the public by March 1, 2004.

"Lack of information increases the time it takes for the IRS to identify and address potential compliance issues efficiently and effectively," Assistant Secretary Olson stated. "The proposed new form will increase transparency for offshore entities, allowing the IRS to better focus its resources and improve compliance. The disclosure will also have a deterrent effect."

"The Treasury Department has adopted measures that do as much as possible to stem abusive tax avoidance transactions without legislative change. We urge Congress to pass the legislation the Treasury Department and IRS proposed in March 2002 to deter abusive tax avoidance and facilitate the upfront identification of questionable transactions," concluded Assistant Secretary Olson.

Related Items:

- Circular 230: Regulations Governing Practice before the Internal Revenue Service: <http://www.treas.gov/press/releases/reports/circular230reg.pdf>
- 6011: Final Regulations Clarifying the Rules Relating to Confidential Transactions: [http://www.treas.gov/press/releases/reports/td9108\(confidentiality\).pdf](http://www.treas.gov/press/releases/reports/td9108(confidentiality).pdf)
- 6662-6664: Final Regulations Intended to Promote Disclosure of Reportable Transactions: [http://www.treas.gov/press/releases/reports/td9109\(penalty\).pdf](http://www.treas.gov/press/releases/reports/td9109(penalty).pdf)
- Announcement 2004-4: Information Reporting With Respect to Foreign Disregarded Entities: [http://www.treas.gov/press/releases/reports/schmform8858_\(ann20044\).pdf](http://www.treas.gov/press/releases/reports/schmform8858_(ann20044).pdf)
- Form 8858 (Information Reporting With Respect to Foreign Disregarded Entities): [http://www.treas.gov/press/releases/reports/form8858_\(ann20044\).pdf](http://www.treas.gov/press/releases/reports/form8858_(ann20044).pdf)
- Schedule M to Form 8858: [http://www.treas.gov/press/releases/reports/schmform8858_\(ann20044\).pdf](http://www.treas.gov/press/releases/reports/schmform8858_(ann20044).pdf)

These will be published in the Federal Register in the next few days and are subject to minor technical changes.